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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. 271

IN THE MATTER OF THE
620 CHURCH STREET BUILDING CORPORATION,
A CORPORATION, DEBTOR UNDER SECTION 77B OF THE BANKRUPTCY ACT.

620 CHURCH STREET BUILDING CORPORATION,
ET AL.,
Petitioners,

vs.

WARNER G. BAIRD, ET AL.,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF AND ARGUMENT ON BEHALF OF PETITIONERS, EMIL ROSENTHAL AND B. K. GOODMAN, OWNERS OF SECOND AND THIRD MORTGAGES ON DEBTOR'S PROPERTY.

(Filed by Leave of Court)

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STATEMENT OF THE CASE.

Because of the advancement of this case for argument, the usual time for filing complete briefs was not permitted. For the convenience of the court and in order that unnec-

essary reference to the short brief in support of the petition for certiorari may be avoided, the original position of petitioners will be herein restated, as well as petitioners' reply to the briefs of respondents. Thus the court will have the contentions of the petitioners under one cover.

The 620 Church Street Building Corporation (hereinafter referred to as Debtor) is a corporation organized under the laws of the State of Illinois. It owns a building in Evanston, Illinois, subject to three mortgages or trust deeds executed by it as follows:

1. First Mortgage dated June 30, 1928 securing bonds in the principal amount of	$445,000
2. Second mortgage dated July 13, 1928 securing notes in the principal amount of	40,250
3. Third mortgage dated June 3, 1931 securing notes in the principal amount of	27,000

The first mortgage bonds and the second mortgage notes were classified and allowed as classes 2, 3 and 4, respectively (R. 13).

The Debtor filed its voluntary petition for reorganization under Section 77B of the Bankruptcy Act on July 12, 1934. Prior to that time defaults had occurred on all of the above mortgages and foreclosure proceedings were pending in the State courts of Illinois. The District Court approved the petition as filed in good faith and all of the above mortgages were allowed as valid mortgages on the property of the Debtor.

A committee representing more than two-thirds of the bonds secured by the first mortgage filed a plan of reor-

ganization which provided that Debtor's property should be conveyed to the 636 Church Street Building Corporation, an Illinois corporation, not a party to the proceedings, having separate and independent stockholders and bondholders, but owning a building adjoining debtor's property. The consideration for this conveyance, under the plan, is to be $222,850 of first mortgage bonds (approximately 33% of total issue) and 25% of the capital stock of the grantee corporation. The plan provides that all such bonds and shares of stock shall be distributed to the first mortgage bondholders of Debtor and that no payment or consideration of any kind shall be given to the holders of the second and third mortgages or to the stockholders. The plan does not provide for a public sale of Debtor's property and gives no opportunity to the second and third mortgages to bid for the property on the same or better terms. It provides no method whereby the second and third mortgage holders may participate in the reorganization and, in a word, wipes out the liens and property rights of the second and third mortgagees.

The plan was accepted only by the committee in behalf of the holders of more than two-thirds of the first mortgage bonds. No acceptance was filed by the holders of the second mortgage or the third mortgage nor by any stockholder all of whom filed objections to the plan.

On March 31, 1936, the District Court entered an order confirming the plan. In the order of confirmation the Court found "that the principal property of the Debtor *has a fair market value* of $245,025 and that there is no equity over and above the $445,500" first mortgage bonds outstanding and "that the Debtor is accordingly insolvent."

The District Court further found that, "based on the evidence concerning the value" of the Debtor's property, "the court has appraised and does hereby appraise" the

claims of second and third mortgagees to be of no value, "there being no equity" in the Debtor's property over and above the first mortgage, and "accordingly no securities, cash or any other thing of value shall be distributed under the plan in respect of any claims" represented by the second and third mortgages "and the acceptance of the Plan by the holders of such claims is not a prerequisite to the confirmation of the Plan" (R. 15).

Questions Presented.

(1) Does Section 77B of the Bankruptcy Act authorize the District Court to approve a plan of reorganization which has not received the consent of two-thirds of each class of claims secured by junior liens, and which does not provide adequate protection for the payment of such claims?

(2) Are the rights of owners of junior liens acquired prior to the enactment of Section 77B of the Bankruptcy Act as Amended, including (a) the right to have the property subject to the junior liens sold at a public sale, and (b) the right to bid at such sale, and (c) the right to make redemption from a sale at the bid price in accordance with the Statutes of the State of Illinois, property rights, within the purview of the Fifth Amendment of the Constitution of the United States, of which the owners may not be divested without their consent?

SUMMARY OF THE ARGUMENT.

I.

The approval of a plan of reorganization by the District Court without the consent of the holders of two-thirds in amount of secured junior indebtednesses, without compensation to them and without making provision for their protection, is not authorized by Section 77B of the Bankruptcy Act, as amended.

A.

Section 77B requires the consent of two-thirds of any recognized class of creditors to a proposed plan of reorganization unless their claims are not affected or unless the plan makes provision for payment to them in full or unless the plan affords other adequate protection for the realization of the value of their interests, if such interests be affected.

Section 77B of the Bankruptcy Act, as amended.

B.

The methods prescribed by the Act for assuring such protection, so far as same are applicable to the instant case, are contained in sub-clauses (c) and (d) of Clause 5 of Subdivision B, which are as follows:

> Clause (c) By appraisal and payment in cash of the value of such claims or liens or, at objecting creditors' election, of the securities allotted to such interests under the plan.

Clause (d) By such method as will, in the opinion of the Judge, under and consistent with the circumstances in a particular case, equitably and fairly provide such protection.

C.

The method and manner of appraising securities held by secured creditors is provided in Section 57 h of the Bankruptcy Act, which is incorporated by express reference in Section 77B providing that the value of securities shall be determined by converting the same into money in one of the several ways indicated by said Section 57 h, as directed by the Court, and these are,

1. By converting the securities into money according to the terms of the agreement pursuant to which such securities were delivered to such creditors.

2. By agreement, arbitration or compromise between secured creditor and trustee in bankruptcy.

3. By litigation.

Section 57 h Bankruptcy Act: U. S. C. Title 11, Section 93, Clause h.

D.

The security of the second and third mortgages, in the instant case, were not evaluated or converted into money according to the terms of the Act.

The District Court appraised the property of the Debtor and from that appraisal concluded that there was no value in the second and third mortgages.

This action is clearly erroneous because the value of the second and third mortgage liens

of petitioners cannot be determined by the ability to collect against the proceeds of an immediate sale of the security.

E.

The plan of reorganization, in the instant case, is a plan in name only since the property which constituted the only asset of the Debtor was conveyed to an outside grantee, the entire consideration for the conveyance being conferred upon the first mortgage bondholders.

F.

If the lower courts be sustained, then first mortgages as well as junior mortgages may be found to have no value or some value less than the amount which the first mortgagees are willing to accept and hence first mortgagees like second mortgagees would be required to abide by a valuation of the security and forego the additional advantages which the mortgage confers.

This is the result which the Circuit Court of Appeals in the Tennessee Publishing Company case denied.

G.

It was not the legislative intent in enacting Section 77B to eliminate redemption and periods of grace.

II.

The rights of junior mortgage holders, acquired prior to the enactment of Section 77B, including the right to hold the mortgaged property (subject to the first mortgage) until the payment of the junior debt, the right to a public sale of the mortgaged property, the right to bid at such sale and the right to redeem after a sale are, under the law of the State of Illinois, substantive rights in specific property and the holders thereof cannot be deprived of them without their consent. If clauses (c) and (d) of subdivision (b) (5) are construed to authorize the destruction of such rights, they violate the Fifth Amendment to the Constitution of the United States.

A.

The rights of holders of second mortgages, like the rights of holders of first mortgages, become vested upon execution and delivery of the mortgage.

B.

The second mortgagee, like the first mortgagee, cannot be summarily divested of the rights procured under a second mortgage.

C.

The right of a junior mortgagee to redeem from a prior mortgage is distinct from, and in addition to his right to foreclose his mortgage.

Jones On Mortgages, 8th Edition, 1363.

D.

The Illinois statute on redemption provides that when any real estate is sold by virtue of an execution, judgment, decree of foreclosure, etc. any defendant or person interested in the premises, through or under the defendant, may redeem within twelve months from such sale by paying the sum for which the premises were sold with interest at 6% per annum. Creditors may redeem if redemption be not made by defendant or party claiming under or through him after the expiration of twelve months and within fifteen months after sale.

Chapter 77, Sections 16, 18 and 20, Illinois Revised Statutes 1931, Smith-Hurd.

E.

The second and third mortgagees, themselves possessing the right to retain their mortgages and the right to foreclose them, were forestalled in any attempt to realize upon their security and from exercising the right to redeem by the approval of the plan of reorganization which ordered the outright conveyance, for the benefit of the first mortgage bondholders, of the property constituting the security for the junior mortgages.

F.

It has been uniformly held that the right of redemption, as the same exists by law in the State of Illinois, is a substantial right constituting a rule of property.

Brine v. *Hartford Fire Insurance Company,* 96 U. S. 627, 636.

Parker v. *Dacres,* 130 U. S. 43, 48.

Fitch v. *Wetherbee,* 110 Ill. 475, 492.

Bronson v. *Kinzie,* 1 Howard, 311, 315.

Buszin v. *Martinowicz,* 178 Ill. App. 519, 523.

G.

The right to redeem being absolute and vested, it is not for the Court to put a price upon it or to declare it valueless.

Cram v. *Cottrell*, 48 Neb. 646.

In Re Georgian Hotel Corporation, 82 Fed. 2nd, 917, 920. (C. C. A. 7th).

H.

The cases cited by respondents in support of the proposition that junior mortgagees have no right to redeem unless the property is sold on foreclosure, do not support the contention, holding as they do, in substance, that it is the debtor's, and not the mortgagee's, right of redemption which may be disposed of in any proceeding which has for its object the liquidation of the debtor's liabilities.

Blair v. *Illinois Steel Co.*, 159 Ill., 350, 368.

American Mine and Equipment Co. v. *Illinois Coal Corporation*, 31 Fed. 2nd., 507, 511 and 512. (C. C. A. 7th)

Beet Growers Sugar Company v. *Columbia Trust Company*, 3 Fed. 2nd, 755, 757. (C. C. A. 9th)

I.

It is not true, as suggested in the respondents' briefs, that a Bankruptcy Court may order a sale free of liens, and thus free of the right to redeem when such sale will bring no more than the amount of the mortgage indebtedness.

Louisville Joint Stock Land Bank v. *Radford*, 295 U. S. 555, 584.

J.

A mortgage junior to a first mortgage confers upon the junior mortgagee the following substantive rights in the specific property described in the mortgage:

(1) The right to retain the lien until the indebtedness thereby secured is paid.

(2) The right to realize upon the security by a judicial public sale.

(3) The right to determine when such sale shall be held, subject to the discretion of the Court.

(4) The right to protect the interest of the junior mortgagee in the property by bidding at such sale whenever held and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale, or by taking the property itself.

(5) The right to redeem from a prior mortgage.

K.

When the first mortgagee forecloses the only right which stands between the irrevocable loss by the junior mortgagee of his interest and the hope of salvaging it, is the right to redeem.

III.

Since the junior mortgagees possess rights in specific property of the Debtor, it is clear, under the doctrine of the Radford case, that they cannot be divested of them by subsequently enacted legislation.

Louisville Joint Stock Land Bank v. *Radford,* 295 U. S. 555, 589.

If Section 77B can be said to accomplish a divestiture of substantive rights in specific property, then it must be held to violate the Fifth Amendment of the Constitution of the United States.

Louisville Joint Stock Land Bank v. *Radford,* 295 U. S. 555, 589.

Conclusion.

To summarize, the Radford Case is decisive of the case at bar recognizing, as it does, the difference between the claims of general creditors and the claims of creditors holding substantive rights in specific property and holding that such substantive rights cannot be divested in the exercise of the bankruptcy power. Therefore, the following conclusions are irresistible:

(1) That a second mortgage does confer substantive rights in specific property.

(2) That Section 77B does not authorize a divestiture of those rights without consent.

(3) If the statute does permit such divestiture without consent of the holders of the second mortgage indebtedness, then it is unconstitutional.

ARGUMENT.

I.

The approval of the plan of reorganization by the District Court without the consent of the holders of two-thirds in amount of secured junior indebtednesses, without compensation to them and without making provision for their protection, is not authorized by Section 77B of the Bankruptcy Act, as amended.

The District Court and the Circuit Court of Appeals evidently assumed that clauses (c) and (d) of subdivision (b) (5) of Section 77B of the Bankruptcy Act authorizes the confirmation of a plan of reorganization without the consent of junior lienholders and without paying any money or other thing of value for the liens. It must be admitted that there is some ground for this assumption in the language used, but as this assumption wipes out certain rights of junior lienors for many years considered and dealt with as valuable and vested, substantive rights in specific property, on the bases of which millions of dollars have been invested in junior mortgages by private and public institutions, it should not be entertained unless the language used leaves no alternative. A timely example of such public investments are the second mortgages by Federal Farm Loan Banks, the purpose of which is to give relief during the depression.

Let us examine the applicable provisions of Section 77B. They are found in subdivision (b), clauses (1) and (5). It is necessary, however, to read in connection therewith the entire subdivision and, as well, the section of the gen-

eral Bankruptcy Act (Section 57 (h)) therein specifically incorporated. The assumption of the courts below appears justified only if regard is had to sub-clauses (c) and (d) of clause (5) of subsection (b), and even then some of the words used must be given an unusual meaning. The provisions of subsection (b), clauses (1) and (5) pertinent to the case at bar, together with clause (h) of Section 57 of the Bankruptcy Act (Section 93 (h) of the United States Code Annotated, Title 11) referred to therein are as follows:*

> "A plan of reorganization within the meaning of this Section shall include provisions for modifying or altering the rights of creditors generally, or any class of them, secured or unsecured, either *through the issuance of new securities* • • • or otherwise; (Subsection (b), clause (1)) • • • shall provide in respect of each class of creditors of which less than two-thirds in amount shall accept such plan • • • adequate protection for the realization by them of the *value of their interests, claims or liens* • • • (Subsection (b), clause (5))
>
> (c) By *appraisal and payment in cash of the value of such interests, claims or liens,* • • • or
>
> (d) By such method as will in the opinion of the judge • • • *equitably and fairly provide such protection* • • • (Subclauses (a) and (b) of clause (5) of subsection (b)) (Italics ours)

Subsection (b), toward its conclusion (about eighteen lines from the end of the subsection) provides:

> "In case of secured claims entitled to the provisions of clause (5) of this subdivision (b), the

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*The entire subdivision is given in appendix A of this brief.

> value of the security shall be determined in the manner provided in Section 93, clause (h) of this title (Section 57 (h) of the Bankruptcy Act) and if the amount of such value shall be less than the amount of the claim, the excess may be classified as an unsecured claim."

The section of the Bankruptcy Law as existing at the time of the passage of Section 77B—Section 57 (h) aforesaid—thus incorporated by express reference, provides:

> "The value of securities held by secured creditors shall be determined by converting the same into money according to *the terms of the agreement pursuant to which such securities were delivered to such creditors* or by such creditors and the trustee, by agreement, arbitration, compromise, or litigation, as the court may direct, and the amount of such value shall be credited upon such claims, and a dividend shall be paid only on the unpaid balance." (Italics ours.)

The above provisions authorize the approval of a plan without the consent of the lien creditors, but the passages in italics clearly require *the issuance of new securities* or protection for the realization by the nonconsenting lienholders of the *value of their interests, claims or liens.* Surely it does violence to the italicized words to confirm a plan which contemplates the issuance of no new securities and which expressly excludes payment and the delivery of anything of value to the lienholders.

While clause (c) expressly authorizes appraisal and payment of claims of nonconsenting lienholders, the later language of the Act with equal definiteness states that in the case of secured claims the value of the security shall be ascertained as provided in Section 57 (h) of the Bankruptcy Act. (Section 93 (h), Title 11, United States Code

Annotated.) Section 57 (h) expressly provides, as one of the methods of ascertaining the value of secured claims, the method provided by the contract under which the security was given. Therefore, in the case of a mortgage, the value may be ascertained by foreclosure proceedings.

It is submitted that if regard is had to the entire subdivision (b) (5) of section 77B and to section 57 (h) of the Bankruptcy Act, there is no clear and unequivocal authority for the order entered by the District Court. In the absence of such clear and unequivocal language, an interpretation which vitiates claims secured by liens long regarded as substantive rights in specific property should not be countenanced.

Clause (c) of subdivision (b) (5) expressly provides for an appraisal of the *value of such interests, claims or liens* but the order of the District Court specifically states that the Court based its appraisal on the evidence of the "*fair market value of the principal property of the Debtor.*" This is clearly erroneous as other factors necessarily enter into the value of liens. The present fair market value of the principal property of the Debtor, if it can be said to have a "market," may (owing to temporary causes such as the widespread depression, the large amount of such property on the market, the temporary shortage of money available for investment in real estate) be very low, but the liens, because they may be enforced against the property and because they may enable the owners to redeem from a sale twelve months thereafter, may be very valuable. The Courts below ignored all these factors.

It may be pertinently inquired, is the plan a plan of reorganization in the sense contemplated by Section 77B? It is called a plan but it is one only in name. The substance of it is the appropriation of the property for the

benefit of the first mortgage bondholders. The Debtor's property is conveyed for certain stocks and bonds of an unknown value, not ascertainable in money, certainly not of a value declared by the Court. For all that appears in the proceedings, the value of the stocks and bonds distributed to the first mortgage bondholders may be worth far more than the amount due them. Such excess, if any, belongs to the junior mortgagees and stockholders. On the other hand, the value of the stocks and bonds issued for Debtor's property may be very low. If the latter is true, why should not the junior lienholders and stockholders, rather than an outsider, be given the opportunity to acquire the property for the low price? Can a plan be called a plan of reorganization which appropriates the property of the Debtor for the benefit of an outside party and distributes a consideration of an unknown value to the first lien creditors? It would seem that if the court were empowered to appraise the value of Debtor's property for the purpose of a plan, then it was only fair to provide for the realization by the junior lienors and stockholders of their interests and claims in the property by giving to them the opportunity to acquire the property at the amount found by the court as the value thereof, namely, $245,025.

Petitioners respectfully urge that what the court authorized is not a genuine plan of reorganization as contemplated by Section 77B. This law was passed by Congress to benefit distressed debtors and creditors alike. All that was done here was that the property of the Debtor was taken for the benefit of a stranger and the first mortgage bondholders to the detriment of the Debtor and second and third mortgage holders.

If the clauses (c) and (d) of subdivision (b) (5) be construed to authorize the consummation of a plan without the consent of an entire class of secured creditors, by

appraising the property of the Debtor at an hypothetical market value, and summarily eliminating a class of secured creditors, if based upon such hypothetical market value of the property, the claims of such secured creditors are given no value, or by paying to such classes of secured creditors the value indicated by the hypothetical market value of the property, then it would inevitably follow that all mortgages, first mortgage as well as junior mortgages, might be found to have no value or only a nominal value because of temporarily depressed conditions, and as a result all mortgages might be effectually barred from participating to the full extent of their substantive rights in specific property. This would enable the Debtor to eliminate all its creditors without their consent and over their objections and carry out a plan of reorganization which would permit the Debtor to keep the property, free of all liens, and alone receive all of the increments and advantages of the increased values of a not distant future. This is exactly the position of the parties in the *Tennessee Publishing Co.* case, which was argued immediately preceding the argument of the instant case. The Congress, it is submitted, did not intend this result and the respondents representing the first mortgage bondholders would be the loudest complainers if the first mortgage holders were treated in this case as were the holders of the second and third mortgages.

No extended argument is necessary to show that the rights of first mortgage bondholders are, in principle, the same as the rights of second mortgage holders. Each class has, on default, among other rights, the title to the property as security for the payment of the debt, the right to foreclose, the right to sell the property at a public sale and the right to bid at the sale. It is true that the junior lienors have all these rights subject to the claim of the first mortgage, but otherwise the rights are identical.

What the law aims to bring about is an opportunity for debtors and creditors to get together and agree on plans of reorganization agreeable to all or at least to a substantial majority of each class of creditors—each yielding something for the sake of harmony and self-interest, along the lines of compositions in bankruptcy. Such agreements have long been authorized by bankruptcy laws in respect of unsecured claims and such laws have uniformly been held valid. Section 77B extends the principle to secured claims and if the law is to be sustained, it must be upon the ground that a plan of reorganization thereunder is merely an agreement between the debtor and all classes of secured creditors with the will of substantial majorities in each class imposed on their respective minorities.

It may be urged that if the consent of each class of creditors is required, the usefulness of the law will be impaired if not wholly obstructed. Particularly, say respondents, will this be the case if the consent of junior lienholders is required. Experience alone can determine this. In the meantime, it may be safely asserted that many plans have been confirmed with the consent of all classes of creditors in proceedings under Section 77B of the Act in the two years in which that Section has been in effect, and particularly has this been the case in England and in the Dominion of Canada where similar laws have been in effect for many years.

On the other hand, petitioners urge that the law will be well nigh useless if debtors and junior lienors are deterred from seeking reorganization under Section 77B for fear that they will lose all their rights through the insistence of the holders of the first mortgage that the debtor's property has a present and temporary market value of less than the amount of the first mortgage which in these times is generally true. If the order of the Dis-

trict Court in this case is allowed to stand by this Court, then under that high sanction, the attitude of the senior security holders will be always one of demanding everything for themselves and giving nothing to debtors and creditors junior to them, while, on the contrary, if petitioners be sustained a more humane attitude of "give and take" will develop which will bring about more harmonious relations between all parties and redound not only to their advantage but to the economic welfare of the nation as a whole. Such, it is earnestly urged, more nearly squares with the probable legislative intent.

Considering the arduous conditions which affected the nation when Section 77B was enacted, it is impossible to believe that Congress intended to eliminate grace periods when periods of grace were so necessary—so necessary, indeed, that moratoria in foreclosures were the legal vogue.

Subdivision (f) of Section 77B of the Bankruptcy Act provides that the Judge shall not confirm a plan unless satisfied that "(1) it is fair and reasonable and does not discriminate unfairly in favor of any class of creditors."

As has been said, the plan in this case deprives the Debtor of all of its property and gives the proceeds thereof only to the first mortgage bondholders, nothing to the second and third mortgage holders or to the stockholders. It is difficult to see how any plan that provides solely for one class of creditors to the absolute exclusion of all other creditors can be a fair plan. It would not even be a fair foreclosure, cutting out, as it does, the right of redemption. The junior creditors were denied even the opportunity of sharing any future increases in value by a conveyance of the property to a stranger, the 636 Church Street Building Corporation. By this conveyance, the loss of the junior lienholders and stockholders was made complete and ir-

revocable. A clearer case of "unfair discrimination in favor of a class of creditors" can hardly be imagined.

Counsel for respondents lay stress on the fact that the court found the value of the property to be less than the amount of the first mortgage. It should, however, be remembered that what the court found was the supposed, fair market value of the property. This necessarily meant the fair market value at the time of the proceedings. The court will take judicial notice of the fact that the nation has gone through a widespread depression, which has temporarily affected all values and particularly the market value of real estate. To take a well known example, the United States Steel Corporation incurred deficits running into millions in recent years. Its common stock sold as low as $25.00 per share only two or three years ago. Today, the common stock is selling at about $75.00 per share, an increase of 200% and it is not at all beyond the realms of possibility that the stock will soon sell at the price prevailing in 1929 when the stock was selling at about $190.00 per share.

The same factors which cause prices of stocks and commodities to rise and fall, operate upon real estate. While the tempo of the price movement of real estate is slower, there can be no denial that it is inevitably affected by general upward and downward trends.

Finally, on this point, petitioners paraphrase a statement recently made by an eminent jurist, namely:

> A plan of reorganization should mean an honest desire to save a Debtor and its creditors from liquidation, keep the Debtor as a going concern, save whatever value there may be in it as a going concern distinguished from a liquidating concern.

Surely nothing can be further from this description than the plan confirmed by the District Court in this case.

For many years junior securities have constituted an important element in financial transactions. Undoubtedly an investor in a junior mortgage is influenced in making his investment by the fact (1) that in the event there should be a default in the payment of his indebtedness he would have the right and the opportunity to foreclose his mortgage and offer the mortgaged property for sale, subject to the prior lien, and (2) that should there be a default in payment of the first mortgage indebtedness, his rights may not be immediately taken away, but that it would be necessary for the first mortgagee to file foreclosure proceedings and if the property does not sell for enough to pay both the first and second mortgages in full, then he would have a period of at least 12 months after the sale to redeem.

II.

The rights of junior mortgage holders, acquired prior to the enactment of Section 77B, including the right to hold the mortgaged property (subject to the first mortgage) until the payment of the junior debt, the right to a public sale of the mortgaged property, the right to bid at such sale and the right to redeem after a sale are, under the law of the State of Illinois, substantive rights in specific property and the holders thereof cannot be deprived of them without their consent. If clauses (c) and (d) of subdivision (b) (5) are construed to authorize the destruction of such rights, they violate the Fifth Amendment to the Constitution of the United States.

The rights of the holders of mortgages, whether first or second, become vested on the execution and delivery of the

mortgages under laws then in existence. In Illinois, upon the execution of a mortgage and before default, the mortgagee is invested with a base or determinable fee title to the mortgaged property. He cannot be divested of this title except by payment in full.

After default, the mortgagee becomes the owner of the mortgaged property subject to the right of redemption. He may bring ejectment against the mortgagor and those claiming under him and exercise all the rights of ownership.

Jones on Mortgages, 8th Edition, Sec. 29.

Lightcap v. *Bradley,* 186 Illinois 510.

Bradley v. *Lightcap,* 195 U. S. 1.

Under the terms of the mortgage, the mortgagee may, on default, proceed to foreclose his lien and in such proceedings obtain a public sale of the property. He has the right to bid at such sale. A junior mortgagee, of course, sells subject to the prior mortgage.

A junior mortgagee has the right to redeem from a prior mortgage at any time after the maturity of the prior mortgage. This right to redeem is distinct from his right to foreclose his mortgage. The right of a junior mortgagee to redeem, says Jones on Mortgages, (8th ed.) section 1363, is a common law right and is entirely independent of the right of redemption given to creditors. The language of most of the cases is broad enough to establish the doctrine that a junior mortgagee has, under all circumstances, the absolute right to pay off, or redeem from, a senior mortgage, past due.

The redemption provisions of the Illinois Statute, as the same existed and were in force at the time of the execution and delivery of the mortgage indebtedness in question,

are contained in Chapter 77 of the Illinois Revised Statutes for 1931 (Smith-Hurd).

Section 16 provides that when any real estate is sold by virtue of an execution, judgment or decree of foreclosure, or enforcement of any mechanic's lien or vendor's lien, or for the payment of money, it shall be the duty of the sheriff, master in chancery or other officer, to give to the purchaser a certificate describing the premises purchased, showing the amount paid, the name of the person in whose favor the execution or decree stands, the amount of the bid and the time when the purchaser will be entitled to a deed, unless the premises be redeemed.

Section 18 of the statute provides that any defendant or any person interested in the premises through or under the defendant may redeem within twelve months from such sale by paying that sum of money for which the premises were sold, with interest at the rate of 6% per annum from the time of such sale. Upon such payment the sale and certificate shall be null and void.

Section 20 of the Act provides for redemption by creditors and states that if redemption is not made by a party entitled to redeem under Section 18 then, after the expiration of twelve months, and within fifteen months after the sale, such creditor may redeem.*

In *Brine* v. *The Hartford Fire Insurance Company,* 96 U. S. 627, this court distinctly held that the statute of Illinois which so allowed redemption confers a substantial right and thereby becomes a rule of property. The court said at page 636:

> "The Legislature of Illinois has prescribed, as an essential element of the transfer by the courts in foreclosure suits, that there shall remain to the mortgagor

*Sections 16, 18 and 20 of the Illinois Redemption Act appear in full hereinafter in appendix B.

> the right of redemption for twelve months, and to judgment creditors a similar right for fifteen months, after the sale, before the right of the purchaser to the title becomes vested. This right, as a condition on which the title passes, is as obligatory on the Federal courts as on the State Courts, because in both cases it is made a rule of property by the Legislature, which had the power to prescribe such a rule. • • • But there is another view of the question which is equally forcible, and which leads to the same result. All contracts between private parties are made with reference to the law of the place where they are made or are to be performed. Their construction, validity and effect are governed by the place where they are made and are to be performed, if that be the same as it is in this case. It is, therefore, said that these laws enter into and become a part of the contract."

Again, in *Parker* v. *Dacres,* 130 U. S. 43, Mr. Justice Harlan, delivering an opinion of this court, said at page 48:

> "In many of the states the right to redeem within a prescribed time after sale under a decree of foreclosure is given, in certain cases, by statute. This right, when thus given, is a substantial one, to be recognized even in the Courts of the United States sitting in equity, because the statute constitutes a rule of property in the State that enacts it. *Brine* v. *Hartford F. Ins. Co.,* 96 U. S. 627; *Hammock* v. *Farmers Loan & T. Co.,* 105 U. S. 77; 88 *Mason* v. *Northwestern Mut. L. Ins. Co.,* 106 U. S. 164; *Conn. Mut. L. Ins. Co.* v. *Cushman,* 108 U. S. 51, 63."

The Supreme Court of Illinois has repeatedly confirmed the statute of redemption of its own state. Thus in *Fitch* v. *Wetherbee,* 110 Ill. 475, the court in commenting upon

the absoluteness of the right of redemption, said at page 492:

> "The right of redemption given by the statute to a decree or judgment creditor is not affected by a failure of the court to provide in its decree for the sale of real estate, with the privilege of redemption. It is the statute that gives the right of redemption, and not the decree of the court. In a case where the statute authorizes a redemption from a sale, a clause in the decree ordering the sale that declares the sale shall be absolute, will not bar that right. That portion of the decree will be regarded as inoperative, and a redemption will be allowed as in other cases. Nor does it make any difference whether the sale was conducted by an officer of the law or by one appointed by the court to perform that special duty."

Other illuminating cases upon the subject are:

Bronson v. *Kinzie*, 1 How. 311, 315.
Buszin v. *Martinowicz*, 178 Ill. App. 519, 523.
Turk v. *Mayberry*, 121 Pac. 665, 669 (Okla. 1912).

The right to redeem by paying the price bid at the foreclosure sale, continuing as it does for 12, and if judgment be obtained, for 15 months, gives to junior security holders a valuable option. Frequently the first mortgagee is the successful bidder, and, as frequently, he bids less than the amount of the indebtedness, as is evidenced by the well nigh invariable practice of taking deficiency decrees. Particularly valuable is the right of redemption in a rising market. Whether valuable or not from a monetary standpoint, however, it is absolute and vested and it is not for the court to put a price upon it or to declare it valueless. As was said in *Cram* v. *Cottrell*, 48 Neb. 646:

> "The plaintiffs had a legal right to redeem, whether or not the exercise of that right would be profitable to

them. It was for them to determine whether they should exercise the right, and not for the court to deny them the right because, in its opinion, its exercise would not be profitable."

The Circuit Court of Appeals for the Seventh Circuit, *In re Georgian Hotel Corporation*, 82 Fed. (2nd) 917, recognized that the right of subordinate creditors to redeem should be observed by the court, saying at page 920:

> "While it is not likely that at the present time the subordinate creditors would have realized anything if the first mortgage had been foreclosed, these creditors would, for three months after one year following the foreclosure sale, have had a right of redemption—a right which might have been valuable. And there is the possibility that, with a substantial 'comeback' in affairs, property values may increase sufficiently to give the debtor a substantial equity in the property of which these creditors would have the benefit."

Counsel for the first mortgage bondholders committee deny that junior mortgagees have the right to redeem in Illinois except when mortgaged property is sold on foreclosure, and they rely upon

Blair v. *Illinois Steel Co.*, 159 Illinois 350.
American Mine Equipment Co. v. *Illinois Coal Corporation*, 31 Fed. (2nd) 507.
Beet Growers Sugar Co. v. *Columbia Trust Co.*, 3 Fed. (2nd) 755.

An examination of the above and other cases cited by counsel for the first mortgage bondholders committee shows that they were led astray by confusing the equity of redemption or right to redeem possessed by a corporation which is the subject of dissolution, general equity receivership or bankruptcy proceedings, and the right to redeem

possessed by a solvent holder of a junior mortgage in no manner involved in a proceeding looking to the distribution of its assets to its creditors.

Certainly the equity of redemption or the right to redeem is a property right and is an asset. If, therefore, the owner thereof be in some legal process of liquidation, then its equity of redemption or right to redeem may be disposed of exactly in the same manner as any other asset may be disposed of in such proceedings. No debtor has the right to retain any property not expressly exempted by law when involved in any kind of legal liquidation. The question, however, is somewhat academic because the instant case is not one of a general equity receivership nor is it a dissolution under state statute. The case arises out of a petition for reorganization filed under Section 77B of the Bankruptcy Act as amended. The affairs, assets and indebtednesses of the Debtor only are involved. The holders of junior liens are not connected with the proceedings except as claimants.

It is true that the Bankruptcy Court may order a sale of the property of the bankrupt free of liens, the liens to attach to the proceeds of the sale. Even this was not done in the case at bar. If a sale free of liens had been ordered, the second and third mortgagees would have had an opportunity to protect their liens by bidding at the sale. Even if the order had been to transfer the property for the stocks and bonds of the 636 Church Street Building Corporation and the liens attached to these bonds and stocks as constituting the proceeds of the sale, then the second and third mortgages would have had a lien thereon, there being nothing in the record to show the value of the stocks and bonds.

It is well established that the Bankruptcy Court may order a sale free of liens only in a proper case where some bene-

fit will be derived by the bankrupt estate, where the delays and expense incident to a foreclosure proceeding may be avoided in the interests of prompt liquidation and where something will be left for distribution to general creditors after satisfying liens upon the property so sold. In no case, however, should a bankruptcy court order such a sale when it is evident that the price which may be expected will be less than the mortgages or other liens upon the property.

This court has spoken with finality on this subject in the *Radford* case where at page 584 Justice Brandeis, in speaking of the sale of the property of the bankrupt, free of encumbrance and transferring the rights of lienholders to the proceeds of the sale, said:

> "But there had been no suggestion that such a sale could be made to the prejudice of the lienor, in the interest of either the debtor or of other creditors. By the settled practice, a sale free of liens will not be ordered by the bankruptcy court if it appears that the amount of the encumbrance exceeds the value of the property. And the sale is always made so as to obtain for the property the highest possible price. No court appears ever to have authorized a sale at a price less than that which the lien creditor offered to pay for the property in cash. Thus, a sale free of liens in no way impairs any substantive right of the mortgage (mortgagee)."

A quick survey of the cases relied upon by adversary counsel will demonstrate their utter inapplicability.

In *Blair* v. *Illinois Steel Co.*, 159 Ill. 350 (Brief of Chester R. Davis, *et al.* page 19), a bill was filed by a judgment creditor alleging the insolvency of the Joliet Enterprise Corporation, praying for the appointment of a receiver,

the dissolution of the corporation and the enforcement of the individual liabilities of the stockholders and directors. A cross-bill was filed in the case by Blair and some of the beneficiaries named in the trust deed in which Blair was Trustee, to foreclose a trust deed which had been executed by the debtor to secure the claims of certain creditors. This cross-bill and the trust deed involved therein were attacked upon the ground that the trust deed constituted an unlawful attempt to prefer creditors.

A receiver was appointed. The debtor corporation defaulted on the bill to dissolve but answered contesting the cross-bills of various creditors in which attack was made upon the trust deed and the bill to foreclose the same. The Illinois Steel Co., together with the Cleveland Rolling Mill Co., answered the cross-bill to foreclose challenging the validity of the trust deed. The trial court held the trust deed to be an unlawful preference and dismissed the cross-bill to foreclose it. On appeal to the Appellate Court the judgment of the trial court was affirmed, whereupon an appeal was taken to the Supreme Court of Illinois.

It is important to observe that the Supreme Court of Illinois rendered two opinions, one upon the original hearing and one upon rehearing. An examination of the briefs of both sides reveals that the question of the propriety of a sale eliminating the right of redemption was not presented. In its first opinion the court did state that in a proceeding under the winding-up statute, which had for its purpose the dissolution of an insolvent corporation and closing up its business and affairs, it was proper to order a sale free of redemption. In this connection it is vital to note that the redemption spoken of was the right of redemption of the corporate debtor which was being dissolved in a proceeding in which its assets were being collected and used in payment of its debts.

Upon rehearing, however, the court decided the only question before it, which concerned merely the validity of the trust deed, and, in so deciding, the court overruled the decree of the courts below in dismissing the cross-bill, held that said decrees were erroneous and remanded the case with instructions to enter a decree in conformity with the prayer of the bill. The language of the Supreme Court of Illinois in thus allowing the foreclosure of the trust deed by the Trustee named therein, the foreclosure to be conducted in the very proceedings originally instituted to dissolve the corporation, is as follows (page 368):

> "We think the decree of the court below in dismissing the cross-blll of appellants was erroneous and should be reversed. The cause will be remanded with instructions to it to enter a decree in conformity with the prayer of that bill."

It is thus apparent that in the opinion on rehearing which actually decided the litigation, there is no mention of a receiver's sale or the right of redemption. The language of the court in its original opinion, respecting sales free of redemption, in view of the decision on rehearing, becomes purely *obiter dictum*. To repeat, even in this dictum the court had in mind only the right of redemption of the debtor itself.

It is the *Blair* case which our learned opponents rely upon as establishing the law to the effect that the right of junior mortgagees to redeem may be obliterated by a receivership sale of encumbered property of the debtor. The *Blair* case constitutes the foundation stone upon which rests one of the main contentions of our adversaries. The *Blair* case being wholly inapplicable, the entire structure of the argument superimposed thereon, falls.

In *American Mine Equipment Company* v. *Illinois Coal Corporation*, 31 Fed. (2nd) 507 (C. C. A. 7th, 1929) (Brief of Chester R. Davis, *et al.*, page 20) a simple contract creditor filed its so-called "general creditor's bill" asking that the court enforce its claim, determine the claims of all other creditors of the Coal Company, marshal the assets and sell and distribute the same among the creditors in accordance with their respective rights. The bill prayed for the appointment of a receiver to take possession of the property and to operate it. The bill also prayed that if it be found to the best interests of the creditors the property should be sold in whole or in part with provision to be made for the preservation of all equities and priorities among the creditors and that the property be sold either subject to, or free and clear from, liens and encumbrances as the court might direct.

The debtor corporation in its answer admitted all of the important allegations of the bill and consented to the appointment of a receiver.

Two days after the filing of the original bill two bills for the foreclosure of separate mortgages upon the debtor's property were filed and consolidated with the original bill of complaint, and the receiver was directed to act as receiver in the consolidated cause. After two years had elapsed during which receivership certificates in an important amount had been authorized and sold, the receiver petitioned the court recommending a sale free of all liens and free of the right of redemption. Thereupon the debtor denied the jurisdiction of the court to deprive it of a statutory right, denied its insolvency and agreed to waive its right of redemption only if a plan of reorganization were adopted recognizing the company's stockholders. The court made a finding of insolvency and authorized the sale as prayed for in the petition holding that such a sale was not

made under a decree of foreclosure. Nowhere in the opinion, however, is there any indication that the mortgagees were denied any priority to which their respective contracts entitled them. The equity of redemption involved was, as in the *Blair* case, the equity of redemption of the debtor. This is distinctly recognized by the court in its opinion when it says at page 512:

> "The equity of redemption was property; and by this voluntary consent to the general administration of all *its* property, and the turning over of all of it to the receiver, *to whose authority the defendant's consent was indispensable,* the defendant in the action conveyed this as well as all its other property, and the court could then direct its disposition with the other property conveyed."

In point of fact the *American Equipment Company* case actually supports petitioners' position. The court particularly noticed *that the mortgagee in that case consented to the sale* by the receiver free of redemption. The court said at page 511:

> "* * * when appellant definitely consented that the property might be sold by the receiver free of the mortgage and other liens, and that thereupon the mortgage and other liens attach only to the proceeds, in our judgment it amounted to a waiver or conveyance of the right of redemption as effectually as if one holding an equity in mortgaged property deeded it to a third person with power to sell it and make title to the purchaser, and satisfy the mortgage out of the proceeds. *Surely this is so if, as was here the case, the mortgagee consents to this arrangement;* for thereby he waives the lien of his mortgage on the property itself, making it impossible for him thereafter to fore-

close, and substitutes therefor a claim upon the proceeds, in respect to which no statutory redemption is provided."

It may be mentioned in passing that the court in the *American Mine Equipment* case relies upon the case of *Blair* v. *Illinois Steel Company* without noticing that the language of the *Blair* case used as authority did not constitute any proper part of the decision as that case was finally determined.

In *Beet Growers Sugar Company* v. *Columbia Trust Company*, 3 Fed. (2nd) 755 (C. C. A. 9th, 1925) (Brief of Chester R. Davis, *et al.*, page 20) the Circuit Court of Appeals of the Ninth Circuit had before it, as did the courts in the two preceding cases, a consideration of the equity of redemption or right to redeem of the debtor itself. In that case an original bill was filed to foreclose a trust deed and a receiver was appointed. Thereafter one of the holders of preferred stock of the company intervened and *with the consent of the corporate debtor* the receivership was converted into a general receivership to determine the rights of all parties to the suit and to wind up the affairs of the corporation. As is observed in the opinion of the court (page 757):

> "To this procedure the appellant consented and it made no objection to the allowance of the order for the enlargement of the powers of the receiver. * * * In so assenting it must be held to have subjected itself to the orders and judgment of the court in the exercise of all of its inherent powers in a receivership case."

Thus, all that is involved in this decision is a sale of the right to redeem *of the debtor* by a receiver who, with the debtor's consent, obtained, by order of court, the enlarged

powers of a general receivership. It is accordingly apparent that the decision has no bearing upon the right to redeem of the holder of a junior encumbrance.

The Court will remember that the District Court in this case did not order a public sale of the property, but confirmed a plan which provided that the property should be sold to a private corporation for a consideration payable in stock and bonds, the value of which depended on other property owned by the grantee corporation and was not ascertained in any manner. The plan did not afford any opportunity to the Debtor or to the junior lienholders to bid for the property and the character of the consideration given by the grantee corporation for the conveyance of the property was such as to preclude any such opportunity.

However, the right of the second and third mortgagees to redeem, is not the only right of which they were deprived. They have other rights under their respective mortgages and on this matter too, this Court has spoken in the *Radford* case.

The right of a mortgagee to insist upon full payment before giving up his security has always been regarded as the essence of a mortgage. This right inheres in a mortgage whether it be a first or a second encumbrance. The only difference between the two is that the second mortgagee may be deprived of his right to subject the property to the payment of his claim by a foreclosure by the first mortgagee. Under the laws of Illinois, when such an event occurs, the second mortgagee has the right to bid at such sale in order to protect his lien and if he is not the successful bidder he has the right to redeem the property from the sale under the first mortgage at the price bid therefor. This right runs for a period of twelve months from the date of the sale. If the first mortgagee does not pursue

his remedy by foreclosure, the right to redeem would continue until all rights under the mortgage would expire under the Statute of Limitations, which in the State of Illinois, is 20 years.

The Radford decision clearly establishes that a mortgagee has the following rights:

(1) The right to retain the lien until the indebtedness thereby secured is paid.

(2) The right to realize upon the security by a judicial public sale.

(3) The right to determine when such sale shall be held, subject only to the discretion of the court.

(4) The right to protect its interest in the property by bidding at such sale whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself.

A first mortgage was involved in the *Radford* case. A second mortgagee has the same rights. The only difference is that these rights are subject to the prior payment of the first mortgage.

A second mortgagee has an additional right as before pointed out, namely the right to redeem the property in case it is sold to satisfy a prior lien. This right to redeem, extending as it does into the future for a period of 12 to 15 months, gives to a second mortgagee a valuable option to purchase the property at the price bid at the sale, which generally is much less than the indebtedness due under the first mortgage.

If clauses (c) and (d) of subdivision (b) (5) of Section 77B be construed as authorizing the erasure of rights

of second and third mortgagees without their consent and without compensation or protection, then, in principle, the rights of first mortgagees may be similarly and without their consent adversely affected. While the rights of holders of junior securities are subject to the prior payment of the indebtedness of a senior lien, such holders of junior securities, nevertheless, possess rights which are in no manner eliminated by the presence of a prior lien. A first mortgagee cannot object to the request of a junior mortgagee to have a public sale, nor can such first mortgagee deny the right to a junior creditor to bid at the sale. Certainly the important right to redeem becomes solidified when the foreclosure by first mortgagee reaches the final stage of a sale.

When a second mortgagee is confronted by a foreclosure of the first mortgage and is unsuccessful in bidding, or is unable to bid at the foreclosure sale, he has one right which stands between the immediate irrevocable loss of his interest and the hope of salvaging it. This right is the right to redeem. It is the very existence of the senior lien and the capacity of the first mortgagee to foreclose it that makes the equity or right of redemption so necessary to the junior lienholder, since it is only by redemption that he can enforce his claim upon the security.

The substantive right in specific property held by the second mortgagee does not depend for its existence upon any priorities in remedies. Although a second mortgage is subject to the first in point of opportunity to receive payment it is dependent upon nothing but its own existence for its own attributes of property and security. When the mortgagor executes and delivers the second mortgage to a creditor, a substantive right in specific property is created and it is as inviolable within its own limits as a first mortgage and, as has been heretofore said, it does

not appear and vanish with the rise and fall of the market.

To deny to whole classes of secured creditors rights which are not in any manner affected by the presence of a senior mortgage and to hold that the clauses of Section 77B before mentioned permit such denial, is to give to those provisions an unconstitutional interpretation.

It is contended by our learned adversaries that:

> "Granted that petitioners' redemption rights were vested property rights under the laws of Illinois, such property rights were subject to be divested as an incident to the exercise of bankruptcy power."

It is at this point that we must carefully take our bearings using the *Radford* case as a chart. There is a difference between simple contract claims against the debtor personally which, it has long been held, may be scaled down and even discharged in the exercise of the bankruptcy power and claims secured by a lien on specific property. There is a sharp difference between a right existing by way of an unsecured claim against the debtor, as to which all general creditors stand upon the same footing, and a creditor who, by virtue of contract and conveyance holds, in addition to his claim *in personam*, an interest in specific property. This difference is clearly perceived and emphatically announced in the *Radford* case which, by its timely pronouncement, will enable some drifting courts to get back to their moorings where they can tie to tested principles of substantive law.

By all processes of logical reasoning, this court, in the *Radford* case, rendered an opinion, the inevitable result of which is to confirm the contentions here made. There this court held the Frazier-Lemke Act unconstitutional be-

cause it proposed to deny property rights under a mortgage existing prior to the enactment of the Statute. At page 589 the court said:

> "Because the act is retroactive in terms and as here applied purports to take away rights of the mortgagee in specific property, another provision of the Constitution is controlling. * * *
>
> "The Bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment. * * *
>
> "But the effect of the act here complained of * * * is the taking of substantive rights in specific property acquired * * * prior to the Act."

Unless it is possible to say, therefore, that the rights of junior security holders are dependent wholly upon a temporary value based upon opinion and found by the court and unless the substantive, although not monetary, rights to require a public sale, to be permitted to bid thereat, and to redeem, are regarded as of no legal significance, it must follow with mathematical inevitability that any attempt to disregard and destroy such rights is an invalid exercise of governmental power. If a statute makes such attempt it is unconstitutional, and if a court by its order produces the same result under a statute which does not authorize it, its order is invalid. In the one case it is a legislative, and in the other a judicial, invasion of private rights.

Because the rights above enumerated, that is, the right to retain the lien until the indebtedness is paid, the right to a judicial public sale, the right to bid at the sale and the right to redeem, are substantive rights in specific property and since all of these rights were disregarded by the order of the District Court, which approved the plan of reorganization, it necessarily follows that the order of the

District Court is invalid because thereby the petitioners were deprived of their property in violation of the 5th Amendment of the Constitution of the United States. If the order is invalid, the Circuit Court of Appeals should have allowed the appeal and should have set the order aside. If clauses (c) and (d) of Subdivision (b) (5) authorize such an order, then clauses (c) and (d) are violative of the 5th Amendment of the Constitution of the United States.

Respondents insist that the holders of the second and third mortgages have not been deprived of substantive rights in specific property because the court found that their claims, interests and liens were of no value; that the Plan afforded "adequate protection" but that such "adequate protection" yielded nothing because the value of the property of the Debtor, as found by the court, was not sufficient to pay the first mortgagee in full. They rely on the opinion of the Circuit Court of Appeals for the Fourth Circuit in *Campbell* v. *Alleghany Corporation,* 75 Fed. (2nd) 947, pages 953-954, from which they quote extensively. We wish to point out, however, that in the case of *Campbell* v. *Alleghany Corporation, two-thirds of each class of creditors consented.* The court used the following language:

> "We do not think that the requirement that secured creditors *scale their debts in accordance with the Plan which two-thirds of them are willing to accept* and which has been approved by the Court as reasonable and fair, and accept in lieu of payment of money such securities as are specified in the Plan, can be said to be such an arbitrary and unreasonable exercise of the bankruptcy power as to amount to a denial of due process."

The following significant language used was also in the opinion:

> "Under the Act, *he is merely required to accept what two-thirds of those similarly situated are willing to accept*, and what the court has found to be fair and reasonable under the circumstances; and when the situation is viewed realistically, it is readily seen that he is not required to surrender any part of the value either of his securities or of the property available for the payment of his claim. What he in fact gives up is merely the arbitrary power to frustrate the wishes of the great majority of those who have a common interest in the property of the Debtor."

All through the language of this case emphasis is laid upon the consent of two-thirds of the class of creditors to be bound by the plan. This is exactly the contention of the petitioners here.

Campbell v. *Alleghany Corporation* was decided prior to the *Radford* case in which the doctrine is clearly laid down that the owner of a mortgage has substantive rights in specific property which do not depend on the value of the security applicable to the satisfaction of the mortgage indebtedness, and that, therefore, the District Court cannot, by ascertaining the present fair market value of the security, determine that a secured lien is valueless and by such determination wipe out such lien.

Under the authority of the *Radford* case, it is clear that the District Court did not possess the power, even had it found a value in the property of the Debtor exceeding the indebtedness under the first mortgage, to compel the holders of the second and third mortgages to take such excess value in full payment of their liens. Radford con-

tended that he had the right, under the Frazier-Lemke Act, to substitute rights of equivalent value for the rights of the mortgagee on his farm, but this court held that the Louisville Joint Stock Land Bank could refuse to take equivalent values and had the power to insist upon its rights as established by its mortgage.

Despite the pontifical expressions of our adversaries to the contrary, there is nothing holier about first mortgages than second mortgages. Both are inviolable to the extent of the rights they confer. As well as first mortgages may resist reorganization in any form which deprives them of substantive rights in specific property without consent, so may second mortgagees resist reorganization which deprives them of their substantive rights, lower down in the scale of priorities as they may be. As surely as a first mortgagee may foreclose ahead of the second, just that surely may the second mortgagee follow in his footsteps and pick up the property by the exercise of the right of redemption.

CONCLUSION

The *Radford* case so repeatedly referred to in the preceding argument furnishes both the test and the answer to the questions here presented. The opinion replenishes and trims an old beacon which lights the way to the correct conclusion of the issues here presented. Under the language of that opinion the case at bar resolves itself into a simple inquiry:

(1) Does a second mortgage confer upon the second mortgagee substantive rights in specific property of the debtor beyond those rights of a mere general creditor possessing no security?

(2) If a second mortgage does confer rights in specific property, may those rights be divested without the consent of the holders of the indebtedness under Section 77B of the Bankruptcy Act as Amended?

The answer is as simple as the inquiry, and it is:

(1) That a second mortgage does confer substantive rights in specific property.

(2) That Section 77B does not authorize a divestiture of those rights without consent, and

(3) If the Statute does permit such divestiture without consent of any of the holders of the second mortgage indebtedness, then it runs afoul of the Fifth Amendment of the Constitution of the United States under the doctrine of the *Radford* case.

It is earnestly urged that the decree below be reversed and the cause remanded to the District Court, for the Northern District of Illinois, Eastern Division, for such further proceedings as this court may direct.

Respectfully submitted,

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